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To the United Nations

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Your Excellencies:

IMF Comments on the Zero Draft "Addis Ababa Accord" on Financing for Development

We would first of all like to take this opportunity to express our appreciation for the strong spirit of cooperation with the IMF demonstrated by yourselves and by the Financing for Development Office in the UN Department of Economic and Social Affairs throughout the drafting process that resulted in this Zero Draft of the Outcome Document ("The Addis Ababa Accord") of the Third International Conference on Financing for Development to be held in Addis Ababa in July. We look forward to participating actively in the drafting session from April 13 to 17. In the meantime, we would like to offer a number of key comments in writing, including specific drafting suggestions, which you may consider useful for the process of further refining the draft document.

We welcome this sensible "zero draft", which, consistent with the Monterrey themes, emphasizes the importance of both national actions and international-level actions in providing a sustainable financing framework for the SDGs. However, while we appreciate the political constraints imposed by the need to incorporate many different comments, the draft in parts still appears overly detailed in its prescriptions. We would like to offer the following comments on the text, where there are a number of issues that, in our view, warrant greater emphasis and several points where clarifications or adjustments would be beneficial:

- **Macroeconomic framework:** The importance of macroeconomic and financial stability, including ensuring a modest level of inflation, as the bedrock of sustainable development should receive much greater emphasis in the economic policy segments of the paper. The need for broadly supportive/stable domestic macroeconomic conditions (stable growth, low inflation, sustainable debt) and political stability as an indispensable part of an enabling domestic environment should be highlighted in particular at the outset of Section II.

- **15-year growth outlook:** The opening section could highlight the extent to which the medium-term growth outlook is less favorable than in the past: there is a significant body of evidence suggesting that trend rates of growth, especially in the advanced economies, are likely to be significantly lower than pre-crisis levels. This would help give context to setting the development goals (to avoid excessive ambition) and to levels of financing (to frame national borrowing strategies around prudent assumptions about growth prospects). Reference to recent IMF/WB analytical work could provide this context.

- **Inter-linkages**: Although priorities at both national and international levels are discussed, the inter-linkages between them could be highlighted in terms of feedback or spillover effects, and their implications could be emphasized in the content of a more interconnected world than 10-15 years ago. The section on domestic policies should highlight the importance of building macroeconomic and financial sector resilience as developing countries further integrate with the global economy and increase reliance on international sources of financing.

- **Differentiation:** The draft could note that, within the broad range of domestic policies in the Accord, country-specific priorities would differ and evolve as countries move up the development ladder. In this context, we also found the inclusion of specific targets for revenues and social spending to be something of a one-size fits all approach, and inconsistent with ensuring that fiscal policies are tailored to individual country circumstances.

- **Efficiency of public spending**. The document appropriately calls for increased spending on infrastructure and social services. Given tight financing constraints, we see a need to place more emphasis on increasing the efficiency of public spending—both in terms of where resources are allocated as how they are spent. (For example, many have argued that major reforms of education systems are needed in many developing countries to ensure that teachers actually spend their time in the classroom). To achieve this objective, public expenditure management will need strengthening. In addition, the document could usefully recognize risks associated both with scaling up public spending and with using alternative types of financing (e.g. fiscal risks of PPPs). These points could be made quite strongly in the document. We offer some suggested language in the attachment but it may be useful to consolidate the message in one paragraph.

- **Tax on financial transactions**. The document supports a tax on financial transactions (¶62 "[countries are encouraged] to help develop and implement additional innovative modalities, including...participating in a financial transactions tax, carbon taxes or market based instruments that price carbon, taxes on fuels used in international aviation and maritime activities, or additional tobacco taxes."). While we strongly support carbon taxes, aviation and maritime fuel taxes, and generally tobacco taxes, we continue to believe that inclusion of the much more contentious Financial Transactions Tax in this list risks distracting from the other alternatives mentioned, which have much greater likelihood of economic success and which are much less contested.

- **Financial stability:** The document rightly highlights the importance of maintaining financial stability. However, the focus is mostly on regulatory frameworks. The document should also call for commitments to strengthening financial sector supervision and enforcement of sound prudential regulations that measure up to international best practice, as these are equally important for financial stability.

- **SIDS:** We welcome the explicit mention of the specific challenges and needs of SIDS that need to be addressed in a strengthened global partnership.

- **Key priority areas:** Last but not least, given the historical opportunity presented by Addis for member states to agree on an international compact, the draft could include a few key areas of priorities as the "Addis imperatives" to ensure that there are specific deliverables that the international community could commit to. We would recommend that these commitments focus on issues that are critical for development in many developing countries but dependent on international cooperation (agreements on tax cooperation, implementation of commitments on climate finance, providing a renewed boost to capacity development and institution building).

The attachment to this letter contains additional specific comments and drafting suggestions.

We look forward to continued constructive engagement with you throughout the entire drafting process and during the conference itself.

Sincerely,

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DETAILED COMMENTS AND DRAFTING SUGGESTIONS BY THE IMF ON THE ZERO DRAFT OUTCOME DOCUMENT FOR THE THIRD FINANCING FOR DEVELOPMENT CONFERENCE

¶4: The first three sentences seem to overemphasize the obstacles attributable to financing constraints (understating the role of policies, which helped many developing countries meet the MDGs). We suggest redrafting the second sentence to emphasize financing shortfalls in specific areas (similar to ¶35). Also, in the same paragraph, when stating that *"some countries have fallen further behind, and inequalities have increased,"* the text should clarify whether this refers to income inequality within countries or across countries (should be within-country as evidence suggests a decline in cross-country inequality given the rapid growth of many countries in the developing world over the past decade).

¶13: The text should reduce the emphasis on industrialization (as opposed to investment) given that the service sector can and does play a very important role in growth and development in many developing countries. Furthermore, we would suggest adding the following language (in red)

"…Infrastructure investment generally entails both public and private investment and sound policy frameworks. National and multilateral development banks (MDBs) play a critical role. We invite all to join us in our endeavor. We agree to ensure domestic and international enabling environments necessary for infrastructure investment. This would include taking steps to increase the efficiency of public investment, including through improvements in public investment management"

¶17: Please clarify how counter-cyclical fiscal policies contribute to, "*equitable growth, poverty eradication and employment creation.*"

¶19: Adopts a revenue target, with the formulation "*countries with government revenue below 20 percent of GDP agree to progressively increase tax revenues with the aim of halving the gap towards 20 percent by 2025; [others] agree to raise revenues as appropriate."* We would suggest that this targeting approach be nuanced by recognizing countries' diverse circumstances, including perhaps by proposing that such targets will need to be embedded in country-owned overall revenue strategies (country-specific targets would need to take account of economic capacity, whether tax composition is progressive or regressive, quality and efficiency of spending, and other country-specific characteristics).

The same paragraph further states that "*we" "commit to substantially increase … technical assistance for tax and fiscal management capacity."* However, it fails to say how this will be done, i.e., who will actually deliver.

We would suggest amending the following sentence as highlighted:
"*Towards that end we are committed to bolstering government revenues to fund increased investment ~~as needed~~ while improving the efficiency of our expenditures."* And to add the following to this paragraph: *"It will also be important for countries to commit to strengthening public financial management and to improving the allocative efficiency of public spending to create fiscal space for priority social and economic expenditures"*

Finally, this paragraph and the entire section on domestic public finance could refer to the role of IMF capacity building technical assistance in boosting the efficiency and reach of tax regimes as well as strengthening public expenditure management.

¶23: Stabilization funds for commodity exporters are a very modest goal. Could be amended to recommend new fiscal frameworks that take a long-term view with regard to inter-generational equity.

¶25*:* The paragraph calls upon competing countries to engage in *"voluntary discussions"* on tax incentives in regional and international fora. It would be better to push for something stronger than more *"discussion"* on this important point.

¶27: We wonder whether it is feasible for the IMF, or any other official institution, to develop official estimates of the volume and breakdown of illicit financial flows (IFF) given that such flows are by their nature concealed from the official sector. Indeed it is not clear that the umbrella notion of *"illicit*" is helpful in guiding either policy formation or estimation: more useful, in our view, is work focused on specific components, such as noncompliance with particular taxes and the amounts at stake in international tax avoidance – areas in which real progress could be made. A reference to the *"know your customer"* rule of AML/CFT toolkit would be useful.

¶32: states that "*Available data indicates that in general, countries need to spend a minimum of $[300] per person in purchasing power parity terms or 10 per cent of GDP, whichever is higher, to provide essential public services. We agree to make every effort to meet this minimum benchmark for all communities by no later than 2025."*

We could not find a source for these numbers and the paragraph does not specify what would be considered essential services. More importantly, there is a risk that countries try to achieve these targets, regardless of the efficiency of the spending (5 percent spent efficiently might be better than 10 percent spent inefficiently). While the Fund supports the underlying objective of ensuring adequate levels of social spending, we suggest removing the language about targets.

¶34: The reference to natural resource accounting appears misplaced. While natural resource accounting is certainly desirable and useful, it does not speak to or help resolve the issue of environmental externalities. Instead, it helps distinguish between output obtained from the extraction of non renewable resources from that obtained from the combination of reproducible inputs (raw labor, human capital, physical capital, social capital, organizational capital and other forms of intangible capital).

¶35: The paper appears to over-emphasize the use of national development banks to help close financing gaps for infrastructure, and for countercyclical macroeconomic policy purposes. It should rather also highlight the risks of this quasi-fiscal spending and concerns with efficiency of spending. We caution that national development banks require very strong governance, transparency, and accountability/oversight structures as well as proper evaluation of projects to be effective. As well, they must meet prudential standards to avoid creating moral hazard that could undermine financial stability, and any government guarantees, or contingent liabilities to government they create, need to be transparently recorded in public debt statistics.

¶36: Should also note the importance of removing energy subsidies as a key expenditure reform for many developing countries.

¶38: Replace *"and FDl largely bypasses countries most in need"* with *"and many countries most in need of FDI still need to create conditions attractive to foreign investors"*.

¶44: The importance of conduct rules enforcement should be mentioned here. Such enforcement is contributing to large global banks retrenching from correspondent banking with banks established in certain EMDEs. All jurisdictions should be invited to ensure that their domestic regulation on financial intermediaries' conduct is in line with international standards and effectively enforced; jurisdictions should actively look for engagement with standard setting bodies (FATF first of all) and subject themselves to regulator international monitoring of their implementation of the standards. Proposed redrafting (new text in red):

- "*We commit to work with relevant partners to lower the cost of remittances, including through ensuring competitive and transparent market conditions, a proper implementation of the risk-based approach called for by the 2012 FATF standards, exploiting new technologies and improving data collection, with a view to reducing the charge for a remittance transfer to less than 3 per cent of the amount transferred.*

¶46: The role of regulation should be mentioned here. The following sentence could be added: *"Ongoing efforts by a BCBS-IOSCO joint task force to establish criteria for identifying simple, transparent, and comparable securitizations should help support a sustainable securitization market."*

¶47: *"We are concerned that short-term cross-border capital flows can create excessive volatility, which should be contained through appropriate regulations, in conjunction with capital account management tools, when appropriate."* There needs to be greater emphasis on cautioning against the use of capital flow measures as a substitute for prudent macroeconomic policies, as recommended in the IMF's policy guidance on the liberalization and management of capital flows.

We suggest the following revision of this point: "We are concerned that short-term cross-border capital flows can create excessive volatility, which should be managed with macroeconomic policies as well as by sound financial supervision and regulation and strong institutions. In certain circumstances, capital flow management measures can be useful. They should not, however, substitute for warranted macroeconomic adjustment." ~~contained through appropriate regulations, in conjunction with capital account management tools, when appropriate.~~

¶50: We would suggest adding the following language highlighted in red: *"We note with concern the large gap in financing for resilient infrastructure and energy necessary for sustainable development. We acknowledge that impediments to investment in resilient infrastructure and energy systems exist on both the supply and demand side. On the project side insufficient investment is often partly due to an insufficient enabling environment and an inadequate pipeline of well-prepared investable projects, but also due to affordability constraints. We also acknowledge that improving public investment efficiency—including project appraisal, selection and management—is crucial to ensure that countries reap the benefits from increased capital spending. To address this, we agree to imbed resilient infrastructure and energy investment plans in our national sustainable development strategies. We commit to ensuring the technical support for countries to translate these plans into concrete project pipelines.*

¶51: In our view, the phrase *"new regulations designed to reduce risk-taking by banks tend to encourage short-term investment behaviors"* does not do full justice to the indisputable need, after the global financial crisis, to tighten the regulation to prevent excessive risk-taking, as agreed by the G-20, and also to the measures put in place to create disincentives to financial institutions' short-termism observed before the crisis (from the principles on compensation to the newly introduced leverage ratio requirement for banks, which affect short-term relatively more than long-term business). The text also does not indicate any action needed to correct the potential bias of financial regulation against finance for development. Proposed redrafting reflects the ongoing work by the FSB (changes in red):

- *"On the finance side, private sector incentive structures ~~and new regulations designed to reduce risktaking by banks~~ tend to encourage short-term investment behaviors, which are inappropriate for many long-term projects, as in the area of infrastructure. This effect could be reinforced by elements of the new financial regulations that, by limiting the risks financial intermediaries can assume, might pose disincentives for infrastructure finance. We invite the standard setting bodies to perform a review of the overall impact of financial regulation and the specific impacts for emerging and developing economies, and to identify any adjustment that might be needed to encourage long-term investments within a frame of prudent risk-taking strategies and robust risk control."*

¶52: We would suggest adding the following highlighted language: "*Projects should be transparent, share risks and rewards fairly, and be implemented following feasibility studies that demonstrate, inter alia, that they are the most effective way to structure the investment. PPPs should not replace or compromise state responsibilities, nor should they impose unsustainable debt burdens or contingent liabilities on governments. Given that PPPs entail significant fiscal risks, governments should strengthen the capacity to properly manage these risks through proper accounting and budgeting for contingent liabilities according to international accounting standards"*

¶62: The Fund has in the past been on record opposing the idea of financial transaction tax, which is being proposed here for the purpose of mobilizing additional official financing for development without considering adverse consequences on the financial sector. First, affecting capital accounts through such a tax runs counter to the need to attract financing into LICs, and is inconsistent with the document's push to liberalize current external transactions to benefit LICs. Second, our longstanding position has been that while we share the aim of ensuring that the financial sector pays a "Fair and Substantial Contribution," robust regulatory reform and improving supervision both nationally and across borders are key, rather than a blunt tool to disincentivize certain financial transactions. The Financial Activities Tax and Financial Stability Contribution, as recommended to the G20, are better suited to addressing basic failures in the taxation of financial institutions; and it is important to address existing distortions in national tax systems (debt bias and VAT exemption). There is ongoing debate on financial transaction tax (e.g., in Europe) which points to the need for close consideration of financial sector taxation, including a comprehensive analysis of unintended consequences for individual countries applying it, as well as spillover implications globally.

¶63. While highlighting the important role of MDBs in financing development, the paragraph should also emphasize that MDB financing should be done with proper considerations for debt sustainability of country borrowers.

¶64: The message could be seen as contradicting the rules-based eligibility for concessional financing and the rules-based graduation from such eligibility especially as it advises "flexible" approach to graduation criteria. If the paragraph has to be retained it should only say that the MDB are encouraged to further refine rules-based frameworks for eligibility and graduation and review those periodically to make sure that the frameworks are fair and are in line with the donors' and members' preferences.

¶67: The link assumed here between investments in marine, freshwater and terrestrial ecosystems and solutions to financial crises is not obvious and could be clarified.

¶79: This paragraph could perhaps be better framed to focus on the economic fundamentals that drive gains—market size and scale efficiencies and increased competition/contestability––that arise from global integration, and that regional integration can be an important part of it.

¶81: In order to be consistent with paragraph 74, we suggest adding a reference to the avoidance of fragmentation of the global trading system as an objective of the negotiation and implementation of trade and investment agreements in paragraph 81. This could be a new second sentence for this paragraph: *"To avoid fragmenting the global trading system, these efforts need to be pursued openly, adopt liberal rules of origin, and foster eventual multilateralization."*

¶83: We suggest adding stronger caveats regarding growth-inducing effects of debt-financed public investment, as the debate about this is still ongoing, even within the IMF, in particular on how to strike the appropriate balance between the benefits and risks.

¶84: The proposal for a central data registry on debt restructurings has been watered down. The question still remains: who will house this? It should be the IMF.

¶86: We suggest changing the last sentence read as follows: *"This would help countries achieve sustainable development."*

¶87: The sentence "*This will require a design of international arrangements that minimizes both creditor and debtor moral hazard, and facilitates a fair and efficient restructuring, that respects the principle of shared responsibility"* should be changed to read *"Key stakeholders should work to minimize both creditor and debtor moral hazard and to achieve fair and efficient restructurings that respect the principle of shared responsibility."* The last sentence in this paragraph should be changed to read *"We welcome the recent work on reforms to the IMF's lending framework and take note of the ongoing work at UNCTAD and the UN in this area"*

¶90: We would suggest that this paragraph mentions the IMF's new Catastrophe and Containment Relief Trust (CCR) specifically, since it has clearly gone beyond others (using the trust, the IMF actually cancelled the debt service falling due to the institution from the three countries).

¶95: Given that the Fund Articles of Agreements define certain conditions for SDR allocation (that its, "general allocations of SDRs should meet a long-term global need to supplement existing reserve assets in a manner that will promote the attainment of the IMF's purposes and avoid economic stagnation and deflation, as well as excess demand and inflation") we would suggest the following amended language in the first sentence:

"We invite the IMF to consider ~~regular and~~ periodic allocations of special drawing rights (SDRs) to supplement IMF member countries foreign reserves, taking into account the benefits and costs of such allocations ~~and to better support developing countries, including LDCs~~."

¶92: A minor comment on the fourth sentence: *"The IMF membership bolstered its lending capacity, and the world's ……"*

¶93: Please replace *"coordination"* with *"dialogue"* or *"cooperation."*

¶96: We recognize the concern on food prices—but the text seems to suggest that part of volatility is associated with speculation (hence a call for ensuring prices reflect supply demand). It would perhaps be better to suggest developing markets/cooperatives for farmers to hedge prices (and at least get better information on price discovery) and improve infrastructure as well as fill trade policy gaps to allow greater flexibility in global food trade—especially vegetables—which can be an obstacle to smoothing localized supply shocks.

¶98: The draft may wish to acknowledge the role of the Independent Evaluation Offices in some IFIs (IMF, World Bank) thus far, as well as the annual Global Monitoring Report, which until now has focused on monitoring the MDGs, and encourage these institutions to continue monitoring the SDGs that are relevant to their mandate.

Sections II.F on systemic issues, **II.G on capacity building and II.H on data and monitoring**):

- Section II.F on systemic issues: On the financial sector, addressing the existing serious information and data gaps is missing in the list of priorities. Data gaps continue to undermine measurement and identification of systemic risk and hence the ability to take prompt corrective action. This could be emphasized in this section and reinforced in section II.H on data, monitoring, and follow up (e.g., para 116). Assisting developing countries to address data gap issues should also be an important aspect of capacity building efforts (section II.G).

- The paragraph on capacity building and peer learning could also refer to the convening power of IFIs such as the IMF to bring together a range of countries at different levels of development and discuss systemic issues of common interest to mutually benefit from diverse country experiences.